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MONTANA LOTTERY

FINANCIAL STATEMENTS
(UNAUDITED)

PERIODS ENDED MARCH 31, 1988

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(Unaudited)
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APPOINTIVE OFFICIALS

Diana S. Dowling, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

Spencer Hegstad, Chairman	Dillon
Pat DeVries	Polson
Glenn Osborne	Great Falls
Jim Moore	Bozeman
Keith Colbo	Helena

LOTTERY LIAISON COMMITTEE

Senator Larry Tveit	Fairview
Senator Larry Stimatz	Butte
Representative Budd Gould	Missoula
Representative John Vincent	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Ted Schwinden, Governor

Ellen Feaver, Director, Department of Administration

Scott Seacat, Legislative Auditor

Bill Norman, President of the Senate

Robert L. Marks, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. Members of the Revenue Oversight Committee include:

Senators	Representatives
Robert Brown	Dan Harrington
Bruce Crippen	Gerry Devlin
Dorothy Eck	John Harp
Thomas Hager	Nancy Keenan
Joe Mazurek	Jack Ramirez
Bill Norman	Mel Williams

In addition, the Speaker of the House requested this report be distributed to the House Business and Labor Committee. The House Business and Labor Committee members include:

Representatives

Fred Thomas	Bob Bachini
Ray Brandewie	Jan Brown
Ben Cohen	Jerry Driscoll
William Glaser	Beverly Donaldson
Stella Jean Hansen	Tom L. Jones
Lloyd "Mac" McCormick	Thomas Nelson
Jerry Nisbet	Bob Pavlovich
Bruce Simon	Clyde Smith
Charles Swysgood	Norm Wallin

July 14, 1988

To the Montana Lottery Commission:

I am pleased to report for the quarter ended March 31, 1988, the Montana Lottery transferred nearly $1.5 million to the State Superintendent of Public Instruction on June 24, 1988---exactly one year after tickets went on sale statewide! Since start up, the Lottery has transferred over $7.1 million. These monies, distributed to eligible counties as equalization aid for retirement funds, provide tax relief for school districts within the state.

For the third quarter, the Montana Lottery recorded ticket sales of over $4.8 million! Lottery retailers received nearly $270,000 in commissions, while winners were paid over $1.4 million in prizes. Included in paid prizes is the first annual installment for the Big Spin Jackpot winner.

The Jackpot, nearing $1 million, was hit at $950,000 on February 17, 1988.

This report reflects marketing changes made after listening to our players:

1. offering a choice between two different games,
2. providing multiple ways to win,
3. creating new ways to enter the Big Spin drawing, and
4. varying the prize structure to offer a large top prize and thousands of lower prizes.

This quarter also heralded the introduction of instant games designed by Montanans for Montanans. "Cabin Fever'88" and "Baseball" reflected themes unique to Montana and prize structures requested by Montanans.

Lottery retailers, our business partners, also provide us vital information. Based on their recommendations, in March we converted 1000 retailers from a weekly to a biweekly delivery cycle. This every other week cycle, reduces the Lottery's telephone, travel, and overtime expense, and allows our marketing representatives more time to assist retailers with training and promotions.

By listening and responding to our players, employees, and retailers, we continue to improve the Montana Lottery to benefit all Montanans.

Sincerely,

Diana S. Dowling

Diana S. Dowling
Director

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MONTANA LOTTERY
BALANCE SHEET
MARCH 31, 1988

	(Unaudited)
ASSETS	
Cash and Cash Equivalents	$ 5,070,805
Receivables (Net)	654,563
Inventories	376,193
Equipment	730,956
Other Fixed Assets	4,093
Accumulated Depreciation	(101,803)
Intangible Assets	714,340
Other Assets	12,909
TOTAL ASSETS	$ 7,462,056
LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 298,710
Lottery Prizes Payable	3,138,402
Due to Other Funds	3,319,183
Installment Purchase Payable	636,816
Compensated Absences Payable	68,945
Total Liabilities	7,462,056
FUND EQUITY:	
Retained Earnings Unreserved	0
Total Fund Equity	0
TOTAL LIABILITIES AND FUND EQUITY	$ 7,462,056

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED MARCH 31, 1988

	Quarter ended March 31, 1988 (Unaudited)	Nine months ended March 31, 1988 (Unaudited)
OPERATING REVENUES:		
Charges for Service		
Net lottery ticket revenue	$ 4,882,601	$ 17,400,710
License and permits	1,100	5,100
Total Operating Revenues	4,883,701	17,405,810
Prizes and Commissions		
Prize expense	(2,213,707)	(7,857,589)
Retailer commission	(269,836)	(965,166)
Net Operating Revenue	$2,400,158	$8,583,055
OPERATING EXPENSES:		
Amortization	$ 42,020	$ 126,060
Personal Services	244,428	741,636
Contractual Services	(154,108)	169,407
Cost of tickets sold	320,090	592,768
Audit Fees	3,483	14,311
Supplies and Materials	13,940	42,868
Depreciation	27,489	83,003
Utilities and Rent	25,391	78,648
Communications	52,399	104,169
Advertising	321,822	538,102
Travel	15,241	45,541
Repairs and Maintenance	20,245	58,621
Management Service Fee	17,116	51,578
Other	1,515	8,874
Total Operating Expense	$ 951,071	$2,655,586
Operating Income	$1,449,087	$5,927,469
NONOPERATING REVENUES (EXPENSES)		
Interest expense		(17,645)
Total Nonoperating Revenues (Expenses)	0	(17,645)
Income before Operating Transfers	1,449,087	5,909,824
Operating Transfers In (Out)	(1,448,580)	(7,143,417)
NET INCOME (LOSS)	$ 507	$ (1,233,593)
Retained Earnings, Beginning of Period	$ 0	1,235,684
Prior Period Adjustments	(507)	(2,091)
Retained Earnings, Beginning of Period as Restated	(507)	1,233,593
RETAINED EARNINGS, END OF PERIOD	$ 0	$ 0

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
March 31, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

These financial statements reflect activity for the Montana Lottery for the quarter ended March 31, 1988 and the nine months ended March 31, 1988.

The Montana Lottery's financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting. A summary of the more significant accounting policies follow:

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or (b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. Due to a limited historical perspective as of March 31, 1988, no reserve for estimated ticket returns has been established.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The retail value of these free tickets distributed approximated $512,000 and $1,901,000 for the quarter ended March 31, 1988 and for the nine months ended March 31, 1988, respectively.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket

cost are reclassified as an advertising expense. For the quarter ended March 31, 1988, Instabuck redemptions resulted in a revenue reduction of $1,870 and a prize expense reclassification of $840.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded based on the face value of tickets delivered to the retailers.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method.

Receivables. Receivables represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts has not been established because no uncollectible accounts existed at the end of the financial reporting periods.

Equipment and Other Fixed Assets. Equipment and other fixed assets are recorded at cost. Depreciation is calculated using the straight-line method over estimated lives of four to ten years.

Inventories. Inventories consist of lottery tickets stored in the warehouse and with the Marketing representatives. These ticket inventories are recorded at cost and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated to not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1987	Net Leave Earned/Used	Balance March 31, 1988
$31,316	$37,629	$68,945

2. INTEREST INCOME

The Montana Lottery's cash is invested daily with other state surplus Treasury cash. The Lottery, by law, is not allowed to invest its excess cash. Using an interest rate of 6.3%, Lottery monies earned approximately $275,519 for the General Fund since July 1, 1987. These interest earnings are not reflected on the Lottery's financial records.

3. PRIOR PERIOD ADJUSTMENTS

The prior period adjustments of $(507) and $(2,091) respectively reflect expense activity from the previous year recorded in the current period.

4. GAMES

Currently, the Montana Lottery games are instant ticket games. This game provides players the opportunity to win instantly by scratching a ticket's latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets for the Big Spin drawing.

5. PAID PRIZES

Section 23-5-1027 MCA states "as near as possible to 45% of the money paid for tickets or chances must be paid as prize money". For the quarter ended March 31, 1988, the prize expense of $2,213,707 reflects 45.34% of net ticket revenues totaling $4,882,601. From January 1, 1988 through March 31, 1988 prizes paid are detailed as follows:

High-tier	$ 346,990
Low-tier	957,203
Big Spin	163,500
	$1,467,693

High-tier prizes reflect prizes greater than $25 paid through Lottery headquarters. Low-tier prizes of $25 or less are paid by the retailer or Lottery headquarters. Free ticket prizes totaled approximately $512,000.

During the quarter ended March 31, 1988, the Lottery awarded one jackpot prize totaling $950,000. Jackpot prizes are paid in equal annual installments of a minimum of $20,000 not to exceed 20 years. The first installment for this Jackpot prize was paid in this quarter. The Montana Lottery will purchase an annuity for the winner for the remaining payments.

6. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION.

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to retirement funds..." For the quarter ended March 31, 1988, the net revenue amounts to $1,449,580.

The $7,143,417 cumulative transfer figure includes the net income for the nine months ended March 31, 1988, and the period ended June 30, 1987. The Lottery was exempted from making a transfer for the quarter ended June 30, 1987 until the general fund start-up loan had been repaid. This loan was repaid on August 19, 1987.

The account "Due to Other Funds" reflects $3,319,183 payable to the State Superintendent of Public Instruction. Of this payable, $1,870,603 represents the transfer for the quarter ended December 31, 1987 paid to the State Superintendent of Public Instruction on May 2, 1988. The remaining $1,448,580 transfer for the quarter ended March 31, 1988 was paid to the State Superintendent of Public Instruction on June 24, 1988.

7. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Each instant ticket game consists of 4,800,000 tickets or other quantity as agreed by the parties.

This contract was extended until March 9, 1989 by letter dated February 23, 1988 and amended on May 5, 1988. The contract amendments address certain ticket specifications, price, and quantity. The amended minimum order quantity is 4,080,000 tickets.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Training. The Montana Lottery contracted with Scientific Games, Inc. on January 15, 1987, to provide training and start-up assistance. This contract for $250,000 required quarterly payments of $62,500 due July 24, 1987, October 24, 1987, January 24, 1988 and April 24, 1988.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the Instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, non-exclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June 1987.

Lottery Consultant. On November 30, 1986, the Montana Department of Commerce contracted with Lottery Science, Inc. for lottery consultant services. These services included organization structure, facility specifications, timetables, game implementation plans, and other recommendations. These services were required due to the July 1, 1987 mandate for an operational lottery.

The contract, covering the period from November 30, 1986 to February 28, 1987, provided for payment of $58.14 per hour not to exceed $30,000, $100 per diem while in Helena, and travel expense reimbursement.

Lottery Consultant. The Montana Lottery contracted with Gaming Dimensions, Inc. on February 27, 1987 for consultant services. These services included timetable development, fiscal and legislative recommendations, security system

design, sales structure, and game implementation plans. These services were obtained due to the unexpected death of the consultant associated with Lottery Science, Inc. The contract terms provide for payment of services at $58.14 per hour, $100 per diem while in Helena, and reimbursement of travel expenses.

This contract was amended on June 1, 1987. The consultant's work was redefined to develop a test of the lottery system software, provide advice on start-up and adequacy of training, and prepare a report on the feasibility of an on-line game and regional lotteries. The amended contract provides for payment of the consultant at $58.14 per hour for a maximum of 160 hours per month, $50 per diem while in Helena, and travel expense reimbursement. The contract expired on December 31, 1987.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
(UNAUDITED)
PERIODS ENDED MARCH 31, 1988

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. This commission on tickets sold to the retailer gives the retailer $25 per book of 500 tickets. The 5% commission of $269,836 and $965,166 for the quarter and nine months ended March 31, 1988 is based on gross lottery ticket sales of $5,396,725 and $19,303,326, respectively.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1027(2), MCA, is allowed "up to 15% of gross revenue for operating expenses." Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. The operating expense percentage for the quarter and nine months ended March 31, 1988, using the accrual basis of accounting, is as follows:

	Quarter ended March 31, 1988 (Unaudited)	Nine months ended March 31, 1988 (Unaudited)
Net lottery ticket revenue	$ 4,882,601	$17,400,710
License and permits	1,100	5,100
Total Gross Revenue	$ 4,883,701	$17,405,810
Operating expenses	$ 951,071	$ 2,655,586
Interest expense	0	17,645
Total Operating Expense	$ 951,071	$ 2,673,231
Operating expense percentage	19.47%	15.36%

Due to increased or decreased financial activity within a quarter, the operating expense percentage will fluctuate above or below the mandated 15% of gross revenue between quarters. However, operating expenses, as determined by the state budgeting process, by law, must be 15% or less of gross revenue over a year's time.

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the quarter and nine months ended March 31, 1988 is detailed below:

	Quarter ended March 31, 1988 (Unaudited)	Nine months ended March 31, 1988 (Unaudited)
Income before Operating Transfers	$ 1,449,087	$ 5,909,824
Prior Period Adjustments	(507)	(2,091)
Net Revenue	$ 1,448,580	$ 5,907,733

PRIZES - Section 23-5-1027(1a) states "as near as possible to 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended March 31, 1988, the prize expense of $2,213,707 reflects 45.34% of the net lottery ticket revenue of $4,882,601. For the nine months ended March 31, 1988, the prize expense of $7,857,589 is 45.16% of the net Lottery revenue of $17,400,710.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

January 1 through March 31, 1988		Percent of Net Lottery Ticket Revenue
Prizes paid	$1,467,693	30.06%
Instabucks	(840)	(.02)
Increase (decrease) in prize liability	746,854	15.30
Prize expense	$2,213,707	45.34%

July 1 through March 31, 1988		Percent of Net Lottery Ticket Revenue
Prizes paid	$5,813,678	33.41%
Instabucks	(840)	----
Increase (decrease) in prize liability	2,044,751	11.75
Prize expense	$7,857,589	45.16%

The prizes paid percentage in both tables is less than the mandated 45% due to the increase in unclaimed prizes and the yet to be purchased annuities for the Jackpot prizes. If these prizes are unclaimed within six months after game end, the remaining funds become available for prizes in other games.